

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Ortiz Analyst: Darrine Distefano Bill Number: SBXX 75
Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: May 1, 2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Energy Efficient Products or Equipment Loan Interest Deduction

SUMMARY

This bill would allow a deduction for interest paid on loans to purchase energy efficient equipment and products.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to encourage energy conservation by providing an incentive to taxpayers to make energy efficient improvements.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would be effective immediately upon enactment. It would apply to taxable years beginning on or after January 1, 2001.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Existing federal and state law allows taxpayers to exclude from gross income any subsidy provided (directly or indirectly) by a public utility to customers for the purchase or installation of any energy conservation measure. An "energy conservation measure" is any installation or modification primarily designed to reduce consumption of electricity or natural gas or improve the management of energy demand in a dwelling unit as defined by federal law.

Existing federal and state laws allow for the deduction of certain expenses when calculating adjusted gross income (AGI), such as trade and business expenses, losses from sale or exchange of property, contributions for pension, profit-sharing and annuity plans of self employed individuals, retirement savings, and alimony. Thus, all taxpayers with this type of expense receive the benefit of the deduction, regardless of whether the taxpayer itemizes or claims the standard deduction. This is known as an "above-the-line" deduction. Federal and state law also allows deductions for moving expenses and interest on education loans when calculating AGI.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

06/18/01

Generally, qualified residence interest (home mortgage interest) may be taken as an itemized deduction for federal and state purposes. Qualified residence interest is limited to interest paid or accrued by the taxpayer during the taxable year on acquisition indebtedness (acquisition loan) or home equity indebtedness (home equity loan). An acquisition loan is the financing to acquire, construct, or substantially improve the taxpayer's principal residence. A home equity loan is the principal amount of any financing, other than the original acquisition loan, that is not more than the fair market value of the residence less the remaining principal balance on the original acquisition loan. The amount that can be treated as home equity indebtedness cannot exceed \$100,000. An interest in the qualified residence must secure both the acquisition loan and/or any home equity loan. However, a debt is not considered to be secured by a qualified residence if it is secured solely by a security interest, such as a mechanic's lien or judgment lien that attaches to the property without the consent of the debtor.

THIS BILL

This bill would allow a taxpayer an above-the-line deduction for interest paid or incurred on any loan or other indebtedness used to purchase and install energy efficient equipment or products on property in California. This bill defines "energy efficient product or equipment" as any product or equipment certified by a utility corporation or local publicly owned utility that improves energy efficiency.

Energy efficient product or equipment includes, but is not limited to, heating, ventilation, air conditioning, lighting, solar, advanced metering of energy usage, window, insulation and weatherization systems.

Any interest that is allowed as a deduction under the bill would be disallowed as a deduction under any other provision of the PITL.

This bill also provides a statement of legislative intent that would encourage public utilities to inform their customers in writing about the deduction provided by the bill.

IMPLEMENTATION CONSIDERATIONS

Implementation of this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

The language in the bill encouraging public utilities to notify their customers about the deduction provided by the bill may be more appropriately located in the Public Utilities Code.

LEGISLATIVE HISTORY

SB 853 (Ortiz, 2001/2002) is similar to this bill but would allow a deduction for interest paid on a loan financed through a utility company to purchase energy efficient equipment and products for California residences. SB 853 is currently in the Senate Revenue & Taxation Committee.

SBX 75 (Ortiz, 2001/2002) contained the same language as contained in this bill. This bill died in Assembly Revenue and Taxation when the first extraordinary session was terminated.

PROGRAM BACKGROUND

Several public utility companies and municipalities have programs to finance the purchase of energy efficient products or equipment. Eligible equipment can include heating and air-conditioning systems, attic and wall insulation, solar domestic water heating systems, and high performance windows.

OTHER STATES' INFORMATION

Review of *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws found no comparable interest deduction for loans used to acquire and install energy conservation equipment on property.

However, *Massachusetts* and *New York* offer a credit for either solar energy devices or energy conservation devices. *Michigan* does not allow an energy-related credit, but exempts the value of energy conservation devices from the local property tax.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would potentially result in revenue losses on the order of \$5 million annually beginning in 2001-02.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of interest expenses not otherwise deducted as part of home equity financing and the marginal tax rates of such taxpayers.

Energy efficient products or equipment that may be acquired and installed on property in this state are rather broad under the bill. Examples of such measures can range in cost from a few dollars for additional insulation to several thousand dollars for a new energy-efficient central heating and air conditioning system in a home.

There are roughly 9.3 million residential units in California consisting of the following types of structures: single family detached and attached, two to four units, and mobile homes. If one in twenty taxpayers owning or occupying the 9.3 million residential units had eligible interest deductions, not otherwise deductible, of \$150 on average, the revenue loss would be on the order of \$5 million assuming an average marginal tax rate of 7.5%.

ARGUMENTS/POLICY CONCERNS

This bill would establish an above-the-line deduction for which federal law has no counterpart, thus increasing nonconformity and the complexity of California tax return preparation.

To the extent interest on acquisition and home indebtedness (i.e. home equity loan or a home improvement loan) is considered qualified residence interest, it is currently deductible as an itemized deduction.

LEGISLATIVE STAFF CONTACT

Darrine Distefano
Franchise Tax Board
845-6458

Brian Putler
Franchise Tax Board
845-6333